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No. 74

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

LONG ISLAND LIGHTING COMPANY, PHILADELPHIA ELECTRIC COMPANY, and THE UNITED GAS IMPROVEMENT COMPANY, *Petitioners*

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO., *Respondents*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF OF LONG ISLAND LIGHTING COMPANY, PHILADELPHIA ELECTRIC COMPANY, AND THE UNITED GAS IMPROVEMENT COMPANY

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It has been over eight years since this Court's decision in *Phillips* directing Respondent[1] to regulate the rates for natural gas sales by producers in the field.

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[1] Reference in all cases is to Respondent Federal Power Commission.

All that Respondent points to since that time in the way of regulatory accomplishment—as distinct from promise—is a set of so-called area "ceilings" which are in large part based on field price levels resulting from years of non-regulation, and six scattered certificate and rate increase orders involving only a tiny percentage of gas moving in interstate commerce. Virtually nothing has been done about the level of prices currently charged by the major producers. At most, Respondent has been able to damp the sharp increase in field price levels, but at an ascending plateau which very probably exceeds producer costs.

Respondent's brief and its orders in *Hunt Oil Company* (discussed *infra*, pp. 11-14, 16-20) constitute virtually a confession of error as to Respondent's obligation to test the lawfulness of major producer rates so as to provide protection during the period pending the development of area rates. Thus, we shall show that Respondent in *Hunt* has conceded the *substantive* validity of every important contention made by Petitioners in this case. However, while the *Hunt* decision, if applied, could become a useful first step towards interim protection, Respondent still refuses to admit that it has any immediate obligation to test Phillips' rates during the indefinite period pending application of effective area rates. Respondent's only colorable excuse for its present refusal to regulate is, as we shall show, its alleged administrative difficulties, including the need to press forward the area proceedings. Petitioners wish to re-emphasize that they affirmatively support Respondent's area rate experiment as a possible long-range solution to many of the problems of producer rate making. However, Respondent's own actions belie its pleas of administra-

tive helplessness; and these in any case provide no adequate excuse for a failure to enforce the Gas Act at this time and in this case.[2]

1. RESPONDENT HAS NOT REGULATED AND IS NOT REGULATING PRODUCER RATES AT THIS TIME UNDER THE STANDARDS OF THE NATURAL GAS ACT

Respondent's own brief leaves no doubt that it does not intend to apply Sections 4(a), 4(b), 4(e) and 5(a) of the Gas Act to the vast majority of producer rates until such time, in the uncertain future, as area rates are actually made effective.

A. Respondent's Initial Prices are Merely Unregulated Field Prices, and No Substitute for Regulation Under Gas Act Standards

Respondent first argues (Br. 37-39) that it is currently protecting consumers by conditioning producer temporary certificates and deciding isolated permanent certificate cases[3] at or approximating "ceiling"

[2] Phillips argues in its brief (pp. 32-38) that Respondent was entitled to terminate its Section 5(a) proceeding, and to do nothing at present about the great bulk of its increased rates, because its test year costs exceeded test year revenues, citing cases such as *I.C.C. v. Jersey City*, 322 U.S. 503. This overlooks the fact that Respondent recognized (R. 329; see also R. 375-381) Phillips' revenues in 1959 and later years might well exceed its costs, but nonetheless as a matter of general regulatory policy chose to defer testing the lawfulness of its current rates pending conclusion of the area proceedings. Respondent for this reason refused to update Phillips' costs or fix its rates for the future. Petitioners challenge this decision as beyond the allowable scope of Respondent's discretion, since it has and will result in an abdication of regulatory responsibility for an indefinite period.

[3] Respondent lists only three such cases, although there have been several others. The vast majority of producer sale applications are merely authorized on a "temporary" basis at the "ceiling" price level and held in abeyance.

or "in-line" price levels. However, it has been demonstrated that Respondent's area ceilings are nothing more than the highest levels reached by field prices after six years of non-regulation,[4] and its "in-line" levels are admittedly merely fair field price levels as of a few years earlier. If further attestation to this is required, Commissioner Morgan has recently furnished it in dissenting from Respondent's recent Fifth Amendment to its SGP61-1 (R. 343[5]) establishing area ceilings (mimeo. pp. 1-2):[5]

> "In CATCO the court placed a continuing responsibility on us, in certificating procedures, to prevent 'out of line' prices and to 'hold the line awaiting adjudication of a just and reasonable rate.'
>
> "Under the terms of our statement of General Policy No. 61-1[3] we have been attempting to carry out our responsibilities through the device of so-called area prices—a currently fashionable synonym for what used to be called 'fair field prices.'"

[3] Issued September 28, 1960, 24 FPC 818."

Commissioner Ross also stated in dissenting from the same order (mimeo. p. 2):

> "The evil inherent in adopting an interim guide line price is the failure to set a standard upon

[4] See Wisconsin-New York Br., pp. 29-36 and App. B thereto. Respondent has recently reduced two of the ceilings slightly, to an "in-line" price level (see fn. 5). This level is, of course, by definition merely a fair field price test, and has never been shown to be "just and reasonable."

[5] By this Amendment, Respondent reduced the area ceiling in Texas District #4 from 18¢ to 16¢. See Resp. Br. 37. Copies of this order and the companion *Skelly* Opinion No. 362 have been furnished to the Court.

which the Commission measured the price. It is all well and good to set forth a number of factors such as 'cost information from decided and pending cases, existing and historical price structures, volumes of production, trends in production . . . .' but the important matter is what is used in practice. Or, in the language of CATCO, what is in-lineness?"

Perhaps most significant, Commissioner Ross stated in dissenting from Respondent's *Skelly* Opinion 362, issued simultaneously with the foregoing Fifth Amendment to SGP61-1 (mimeo. p. 4):

"In my view, the administrative embarrassment of a backlog and the administrative difficulties of conducting individual hearings and making decisions therein does not warrant prohibiting either the producer from seeking legitimate increases or the consumer from contesting the validity of the interim prices if such interim prices are to be the way of life for a number of years. It is hardly any consolation to either party to say 'don't worry, we will review them periodically and use our ouija board to set new prices.' I am less than enthusiastic about my expertise to conjure up a fair price without the benefit of hearings in which parties can introduce evidence of in-lineness, favored nation and triggering clauses in accordance with CATCO. Also, as Judge Fahy suggests in *Wisconsin* vs. *F.P.C.*, *supra*, in his dissent, the Commission should not be affirmed in failing to decide present cases. It is true that that case involved Section 4(e) and 5(a) proceedings but the philosophy is the same."

It is obvious that consumers are irreparably injured to the extent Respondent sanctions, even on a temporary basis, the collection of non-refundable "ceiling" prices which are later found "unjust and unreason-

able" in area proceedings. Given the genesis of Respondent's SGP61-1 ceilings, it is highly unlikely, to say the least, that they represent just and reasonable rate levels. It follows that the Commission is virtually assuring collection of unlawful rates when it permits producers such as Phillips to initiate under Section 7 and collect indefinitely millions of dollars in non-refundable high initial rates, without even the prospect of future review in Section 5(a) proceedings (see also Pet. Br. 20-25).

B. Respondent Has Decided Virtually No Rate Increase Cases

Respondent also argues that it is providing adequate protection against increased rates by orders under Section 4(e) of the Gas Act. The three Section 4(e) rate orders cited by Respondent (Br. 40-41) as an effective regulatory program from 1955 to date involve South Louisiana increases totaling $1,235,456 on an annual basis at prices largely in excess of 25 cents per Mcf. These increases constituted eight-tenths of one per cent (by annual dollar amount) of annual rates currently subject to refund which are accumulating at $158 million a year and aggregate an estimated three-quarter billion dollars (Pet. Br. 16). When it is recognized that 72 per cent of South Louisiana gas purchased by interstate pipelines (Pet's. Br. App. D-1; see also App. A, *infra*, p. 27) is sold at prices exceeding the Commission's "in-line" price[6] of 20 cents per Mcf, and that even this price has never been found "just and reasonable", it is obvious that these orders barely touch on the increased rate problem, even in South Louisiana. It follows that

[6] As determined on remand from *Atlantic Refining Co.* v. *Public Service Comm'n of New York*, 360 U.S. 378.

the approximately three-quarter billion dollars in producer revenues subject to refund continue to mount unchecked by the application of the Section 4(e) standards of the Act.

Petitioners (Br. 16-10) have pointed out that for political and economic reasons, it is improbable that very large accumulated refunds could be ordered even if the underlying rates were found unlawful. Further, the necessary teaching of this Court's *Tennessee Gas* decision (No. 48, December 3, 1962) is that Respondent will not be able to grant adequate retroactive relief under Section 4(e) of the Act against accumulated unjust and unreasonable rate increases even assuming that full refunds could be made at the conclusion of the area proceedings.

In *Tennessee Gas*, this Court sustained against constitutional objections an "interim" pipeline rate reduction order on the ground that consumers could be effectively protected only by making an immediate reduction in that portion of the pipeline's rate increase found unlawful. The fact that the increased rates were refundable in their entirety (so that any overpayments would ultimately be recovered) was held inadequate "'to protect consumers against exploitation at the hands of natural gas companies . . . .' *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944) and 'to underwrite just and reasonable rates to the consumers of natural gas . . . .' *Atlantic Refining Co.* v. *Public Service Comm'n of New York*, 360 U.S. 378, 388 (1959)." (Slip Op. 9.) As the Court stated:

> "* * * True, the exaction would have been subject to refund but experience has shown this to be somewhat illusory in view of the trickling down process

> necessary to be followed, the incidental cost of which is often borne by the consumer, and in view of the transient nature of our society which often prevents refunds from reaching those to whom they are due. It is therefore, the duty of the Commission to look at 'the backdrop of the practical consequences [resulting] . . . and the purposes of the Act,' *Sunray Mid-Continent Oil Co.* v. *Federal Power Comm'n*, 364 U.S. 137, 147 (1960), in exercising its discretion under § 16 to issue interim orders and where refunds are found due to direct their payment at the earliest possible moment consistent with due process. In so doing under the circumstances here the Commission's ultimate action in directing the severance and in entering the interim order was not only entirely appropriate but in the best tradition of effective administrative practice." [Footnote omitted. Slip Op. 9-10]

This holding applies axiomatically here, since pipelines pass on producer rate increases to their customers in the form of rate increase filings which are in turn passed on to consumers.[7] Since Respondent has urged and the Court has held that refunds of unlawful pipeline rates provide inadequate protection, refunds of producer rates—even if ordered and passed on by the pipelines—necessarily provide inadequate protection, and for the identical reasons.

It follows that Respondent's extended argument (Br. 42-44) that consumers are adequately protected by the possible refundability of high-level South Louisiana

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[7] As Respondent has frequently noted (e.g. 1961 Annual Report, p. 76), pipeline increases are largely the result of producer increases. Thus, the cost-of-purchased-gas increase underlying the *Tennessee Gas* rate filing in No. 48 bulked five times as large as the rate of return reduction ordered by Respondent in that case.

rates overlooks and is conclusively refuted by its vigorously argued position to the contrary in No. 48, This Term.[8]

Finally, it is by no means clear that Respondent will be able to provide even *prospective* protection against existing high-level field prices if and when the area proceedings are concluded. Present day field price levels do not present merely an "interim" regulatory problem but are rather the result of the failure to regulate for eight years. Each month that Respondent delays in attacking the charges made by major producers, such price levels become more firmly imbedded in our economy. Experience in rate or price regulation, including OPA and OPS regulation during the recent wars, demonstrates that it is impossible to "roll back" consumer prices which have become fixed and established in the economy without subsidizing persons who have paid increased production costs. Price regulators have long recognized that it is essential to "nip in the bud" price increases before the economy has had an opportunity to adapt itself to the fact of the higher price. Thus, wartime price regulation has usually sought to prevent price increases, not attempt

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[8] Respondent's (Br. 42-44) attack on Petitioners' use of Respondent's admittedly inadequate data on producer rate refundability and price distribution ignores the fact that these data are the only available usable information on these topics, and that the inadequacies of the data (plainly flagged in Petitioners' brief, pp. 22-24) are solely Respondent's responsibility. Respondent's contentions as to the refundability and price distribution of South Louisiana rates (Br. 42-44), including the statistical treatment in App. C to its brief, are examined in App. A *infra*, pp. 27-31.

to undo them retroactively.[9] Respondent, however, is proceeding on exactly the opposite assumption: that it will be able to reduce both retroactively and prospectively field price levels on which the business of producers will be built and on which the entire economy of the oil and gas industry will increasingly depend. The greater the delay in regulation the greater the likelihood that producer expectancies as to increased rates will be recognized and left undisturbed.

Respondent in its brief has necessarily admitted, therefore, that, aside from a few scattered and minor cases, its current affirmative regulatory program consists of an attempt to freeze initial prices at recent field price levels, as well as to subject some rate increases to refund liability.[10] It has not applied and does not intend to apply Sections 4(a), 4(b), 4(e) and 5(a) to the great bulk of producer rates until the day many years hence when it hopes to have valid area pricing in force.

Respondent's brief has therefore served to clarify and sharpen the primary issue before this Court: *Can Respondent's alleged administrative difficulties justify an admitted failure to apply Sections 4(a), 4(b), 4(e) and 5(a) to producers of natural gas for an indefinite period following this Court's* Phillips *decision?*

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[9] See Pegrum, Dudley F., *Public Regulation of Business*, 1959, pp. 223-225; Fainsod, Merle, et al., *Government and the American Economy*, 1959, p. 867; Wilcox, Clair, *Public Policies Toward Business*, 1955, pp. 693-694; Nelson, Saul, "OPS Price Control Standards", *Law and Contemporary Problems*, 1954, pp. 558, 570; Hardy, Charles O., *Wartime Control of Prices*, 1940, p. 14.

[10] The effect of the producer rate settlements approved by Respondent is discussed *infra*, pp. 14-16.

2. RESPONDENT'S OWN ACTIONS DEMONSTRATE THAT IT CAN PROVIDE THE VERY TYPE OF EFFECTIVE INTERIM REGULATION PETITIONERS SEEK HERE.

Turning to this issue, it is striking to note that Respondent's defense of its current regulatory inaction moves in two directions simultaneously. On the one hand, the Commission protests that it has an effective interim regulatory program, citing *inter alia* decisions in six isolated cases involving a tiny percentage of sales moving in interstate commerce, and ignoring the approximately three-quarter billion dollars in suspended increases outstanding and the vast amounts of gas now flowing at above-ceiling rates. Respondent also points to settlements reluctantly agreed to by intervenors at rate levels consistent with its area "ceilings" which, as we have seen, are almost certainly not just and reasonable rate levels.

On the other hand, Respondent argues that for administrative reasons it cannot mount more of an interim regulatory program; that it cannot give present day consumers greater current protection because it must utilize its staff to develop a regulatory program which may or may not protect future consumers.

We have already pointed out (Br. 11-15) that Respondent cannot sacrifice existing consumer interests for its own administrative convenience in developing a future regulatory program. Respondent's recent actions seem to indicate a partial acceptance of this principle.

A. Respondents' Recent Order in Hunt Oil Is Tantamount to a Confession of Error in This Case.

We have seen that Respondent's position has somewhat narrowed since its briefs in the Court of Appeals and in opposition to certiorari in this Court. Respondent no longer argues that it would be technically impossible to utilize the major producer rate cases in

order to provide interim protection against current rate levels. Indeed, it would be difficult for it to do so in the light of the numerous Examiners' Decisions recently issued deciding producer cases following Respondent's own precedent,[11] and in the light of Respondent's remand of the *Hunt* case (App. B, *infra*, p. 32; discussed further *infra*, pp. 16-19) and its announced decision actually to decide the "Section 4(e) aspect" of that particular case.

The *Hunt* decision is the second in line of a number of major producer rate cases which have reached Respondent for decision (Pet. Br., App. A, p. 33). *Hunt* amounts virtually to a confession of error on the major *substantive* points raised by Petitioners in this case. Thus, Respondent in *Hunt* has concluded that:

(1) "The use of individual company costs as a method for determining whether an independent producer's increased rates are just and reasonable appears to be necessary if we are to pass upon such rates at all prior to the establishment of area rates" (App. B, *infra*, pp. 36-37);

(2) Accordingly, it is necessary under the Natural Gas Act to determine the justness and reasonableness of Hunt's increased rates[12] tested by its individual costs, updating the 1957 test year if necessary by the introduction of current costs (App. B, *infra*, pp. 37, 39);

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[11] Copies of these unreported decisions have been supplied to the Court.

[12] With two inconsequential exceptions (R.S. 49, 50), all of Hunt's current increased rate schedules are involved in rate proceedings consolidated in its rate case, so that Respondent will necessarily determine the lawfulness of substantially all of that company's increased rates in passing on the consolidated dockets in this proceeding on the basis of current costs. See further, *infra*, p. 18.

(3) It is necessary under the Natural Gas Act to determine whether Hunt's increased rates are unduly discriminatory or preferential, regardless of whether or not its over-all revenues are supported by over-all costs (App. B, *infra*, p. 36);[13]

(4) It may prove necessary under the Natural Gas Act to test the lawfulness of Hunt's non-refundable rates in the course of passing on its increased rates; Hunt's Section 5(a) case will be held open for this eventuality (App. B, *infra*, p. 37).

This is, of course, the identical relief sought in this case, except that Respondent has deferred directing its Examiner to apply Section 5(a) to Hunt's non-refundable rates until such time as it becomes apparent that area rates will not be available for this purpose. However, it is virtually certain that Respondent will eventually have to decide the "Section 5(a)" aspects of the *Hunt* case, merely in order to be able to decide the increased rate or "Section 4(e)" aspects. We show in Part 4, *infra*, p. 23, that effective area rates cannot be expected for many years. To comply with Respondent's directive, the Examiner will be required to reduce Hunt's increased rates if he finds either (a) that its over-all revenues exceed its over-all cost of service in the test year, or (b) that the increased rates or any of them are unduly discriminatory or preferential when compared with Hunt's other rates. It will almost cer-

[13] Respondent argues (Br. 53) that the *Phillips* record would not permit an application of the Section 4(b) "discrimination" test to Phillips. If this is the case, why was Respondent not obliged to develop a record which would, as it intends to do in *Hunt*? Counsel's discussion of Respondent's obligation to apply Section 4(b) to individual high level rates (Br. 53) is at complete odds with the *Hunt* order (App. B *infra*, p. 36).

tainly be impossible for the Examiner to accomplish this if he cannot adjust the non-refundable rates under Section 5(a).[14]

Respondent (App. B, *infra*, p. 37) indicates that it intends to follow the procedure adopted in *Hunt* in other major producer cases, and that decision undoubtedly represents a forward step in interim consumer protection. However, while Respondent has conceded the validity of Petitioners' contention that these cases provide the only available means of consumer protection pending the development of area rates, it has not taken the final step of setting lawful future rates under Section 5(a) which is essential to provide that protection. We discuss *infra*, pp. 16-20. Respondent's unwillingness thus far to apply its *Hunt* procedures to Phillips' increased rates based on its current costs.

B. The Current Producer Rate Settlements Demonstrate That Individual Producer Regulation Is Feasible on an Interim Basis, But in Themselves Provide Inadequate Protection.

The recent settlements of producer rate cases relied upon by Respondent (Br. 39-40)[15] also could be charac-

[14] Hunt's non-refundable rates bulk large in Hunt's revenues, since it currently receives about 43% of its revenues under non-refundable schedules. Since the Examiner at this point cannot adjust these rates, even prospectively, it will probably be impossible for him to adjust Hunt's increased rates and thus its over-all revenues sufficiently so as to conform to the "just and reasonable" standard, which necessarily involves a comparison of Hunt's over-all costs and revenues. Further, reduction of Hunt's high increased rates to eliminate undue discrimination may require a counterbalancing increase in certain of its non-refundable rates to bring its future revenues in line with its costs. This would also be impossible under Respondent's order.

[15] Since the preparation of Appendix A to Petitioners' main brief, the *Hunt* case has been remanded, as noted above, and there have been examiners' decisions in *Gulf* and *Sohio*. Copies of these decisions have been furnished to the Court.

terized as a form of current major producer rate regulation, albeit a wholly inadequate one. In these cases, there has first been a finding by the Examiner of the producer's individual, company-wide costs of finding and producing gas, or a cost determination presented in evidence by Respondent's staff. The parties have then negotiated a settlement, setting rates for the future not on costs but following the rough outlines of Respondent's area or ceiling rates, but always with certain significant exceptions. Invariably, Respondent by approving these settlements has afforded the producer an opportunity to earn future revenues substantially exceeding the costs found by the Examiner or determined by its staff.

The cost of service determinations *have* been used, perhaps paradoxically, in determining the producer's liability to refund past payments in excess of the various settlement rate levels; i.e., the producer has been permitted by Respondent to forego such refunds in years in which its revenues did not return cost of service. This amounts, of course, to a backhanded recognition of the validity of such cost determinations.[13]

Thus, Respondent has gone three-quarters of the way toward individual company regulation pending area rate development. It has abdicated its function only at the stage of actually applying costs to derive a set of just and reasonable rates for the future. This, unfortunately, is the major purpose of regulation under the Natural Gas Act.

[13] Intervenors, such as Petitioners, have acquiesced in settlement rates in default of more effective regulatory protection. The alternative would be to continue paying indefinitely high, non-refundable initial rates, as well as rates subject to refund obligations which, as Respondent has admitted, provide no real protection to consumers.

It follows that, while Respondent in one breath is arguing that it cannot for administrative reasons utilize the major producer cases as an interim regulatory device, in the next breath, it is in fact arguing that it has done so in a manner of speaking, and that its half-way measures provide adequate protection under the Act. Petitioners agree that Respondent could protect present day consumers by deciding these cases, although they vigorously disagree that Respondent's performance thus far has been adequate. They strongly urge that this Court reinforce Respondent's belated recognition of its regulatory responsibilities by a direction to act responsibly to protect existing consumer interest.

3. IT IS MANIFESTLY POSSIBLE FOR RESPONDENT, WITHOUT CRIPPLING ITS AREA EXPERIMENT, TO USE THE EXISTING MAJOR PRODUCER CASES TO PROVIDE INTERIM REGULATORY PROTECTION. IT SHOULD BE DIRECTED TO DO SO

The place to begin such an increased effort to protect existing consumers is this case. We have noted above that Respondent has recognized that it should decide (if necessary on the basis of recent cost data) at least the 4(e) aspects of the *Hunt* rate case, the second producer case after *Phillips* to reach it for decision (App. B, *infra*, pp. 32-40). Hunt Oil Company is a small producer[17] whose rates do not loom large in the overall picture of producer rate regulation. Phillips in contrast is a giant, selling approximately 10 per cent of the gas moving in interstate commerce, and its rate levels can have a profound economic effect on all producer sales in all areas. We have seen that Phillips'

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[17] Hunt in 1960 ranked 58th in sales of natural gas in interstate commerce (*1960 Sales by Producers of Natural Gas in Interstate Commerce*, Federal Power Commission).

current Section 4(e) increases subject to refund aggregate approximately $22 million on an annual basis with a cumulative amount undoubtedly several times this figure. We have seen that Phillips' unit revenues increased more than 50 per cent since its 1956 costs were determined; and that Phillips at present is making sales at non-refundable rates which produce revenues exceeding by $3 million annually those which would be produced if its rates were consistent with Respondent's increased field price levels (Pet's. Br. 16, 22). *Hunt* in contrast involves current rate increases totaling only $254,940 annually. Hunt's sales under non-refundable rates produce revenues exceeding those which would be produced by Respondent's increased field price levels by only $85,053 per year. Despite this contrast, Respondent has refused to decide more than a trivial fraction of the 4(e) aspect of the *Phillips* case.

Respondent attempts to reconcile its action here and in the *Hunt* proceeding by arguing that much more regulatory effort would be involved in deciding the Phillips 4(e)'s than the Hunt 4(e)'s, possibly because of the relative size of the two companies (Br. 41).

Actually, *Hunt*, as Respondent's decision suggests (App. B *infra*, pp. 32-36), will involve substantially more staff effort than would even a decision limited to Phillips' outstanding rate increases. In *Phillips*, Respondent has reached a decision as to all governing principles, and needs merely to update the figures in Phillips' already determined cost of service to a more recent test year. Experience demonstrates that this need take only a few months, despite Respondent's contrary

suggestion (Br. 46).[18] *Hunt*, however, was tried prior to the *Phillips* decision and it will be necessary to apply most of the important *Phillips* principles to Hunt's particular operational and cost picture for the first time; i.e., to retry the case in some important respects.[19]

Respondent may argue that its *Hunt* and *Phillips* orders are reconcilable because it intends to grant in *Hunt* only the limited relief it granted in *Phillips*, i.e., decide only the consolidated Section 4(e) proceedings. Actually, whereas Phillips' consolidated rate increase proceedings involved only about 21% (by annual dollars) of its current sales under increased rates, the *Hunt* proceeding (as we have already noted *supra*, p. 12, fn. 12) involves at least one docket covering each of Hunt's increased rate schedules (except Rate Schedules 49 and 50 where the non-consolidated rate increases aggregate $3,200.00 a year). Thus, Respondent in deciding the consolidated dockets, will determine the "just and reasonable" and "non-discriminatory" rate level for virtually all of Hunt's increased rate schedules based on a 1957 test year updated by current costs. Respondent could hardly allow Hunt to continue to collect, under later non-consolidated, rate increase filings, rates which it had found unlawful

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[18] Phillips has supplied 1960 cost data in the Permian Area proceeding, AR61-1. Respondent's suggestion (Br. 46) that there may be changed circumstances in *Phillips* which will require attention is of course true. This does not negate the fact that the job has largely been done.

[19] Thus, the Examiner will be required to apply for the first time to Hunt's new production volumes the *Phillips* principles governing allocation of production costs and cycling and gasoline plant costs, two of the three most important cost elements—the third being exploration costs (App. B, *infra*, pp. 33-35).

when measured against current costs. It is clear, therefore, that Respondent will of necessity determine the lawfulness of virtually all of Hunt's increased rates.

The unanswered question, therefore, is why if Respondent considered it in the public interest and necessary to determine the justness and reasonableness and non-discriminatory character of Hunt's current increased rates, it did not also consider it necessary and in the public interest at least to decide the justness and reasonableness and non-discriminatory character of Phillips' current increased rates.

Additionally, while Respondent (Br. 42) unaccountably neglects to mention it, we have already pointed out that Respondent held open the Section 5(a) aspects of the *Hunt* case for possible future decision, stating:

> "The Section 5(a) aspect of the proceedings is in a different posture. There are currently pending area rate proceedings in the Permian Basin and Southern Louisiana in which a large percentage of Hunt's jurisdictional sales are the subject of investigations pursuant to Section 5(a). It is our hope that area proceedings will result in a timely determination of Hunt's rates for the future. However, in order to assure adequate protection to consumers against any unreasonably high rates of Hunt which may not be subject to an early determination on an area basis we will hold in abeyance further action on the 5(a) aspects of the case pending area rate determinations, with the understanding that 5(a) proceedings on some or all of Hunt's rates may be subject to reactivation if future circumstances should so dictate."

This is in marked contrast to the action in this case where Respondent saw no need to appraise the reason-

ableness of Phillips' many over-ceiling prices under Section 5(a), until such time, in the uncertain future, as the area proceedings are concluded.

Respondent, in view of the foregoing history, can hardly argue that it would be impossible to test the lawfulness of major producer rates pending the development of an area rate method, and we do not understand it to do so. Rather, Respondent's principal position (Br. 44-48) is that effort spent on existing producer regulation will delay or complicate its experimental area rate program, which is, as we have shown, not an adequate reason for deferring regulation indefinitely. Furthermore, Respondent nowhere answers one of Petitioners' principal contentions that application of the Natural Gas Act to major producer rates *now* will further, not hinder, the development of viable area rates.

We have shown that the energy which Respondent now expends in appraising settlements and deciding piecemeal isolated initial price and rate increase cases results in no real protection to the public. Such an effort is necessary, as two Commissioners have recognized, solely because of Respondent's failure to establish major producer system costs and rate methods so that "4(e) proceedings could be handled expeditiously and fairly pending the establishment of firm area rates without resorting to dismissal proceedings." Commissioners Ross and Morgan, dissenting, Opinion No. 369, November 30, 1962, Mimeo. pp. 5-6.[20]

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[20] An earlier order in this proceeding is cited at Respondent's brief, p. 41, fn. 28. Copies of Opinion No. 369 have been furnished to the Court.

The current fragmented regulatory effort, if applied to the actual task specified by the Act—the setting of just and reasonable rates—could offer very substantial, even if not perfect, protection to consumers during this interim period. Petitioners (Br. 26-29) have already pointed out that decision of the major producer cases would lay a foundation for a program of area rate making both by establishing costing principles which would have to be established in any case in the area proceedings, and by eliminating or minimizing the backlog of rate refund and initial price cases which now threaten to bury the area experiment in a hopeless morass of issues and data.[21] Such considerations may well have been at the back of Respondent's mind in undertaking (App. B, *infra*, pp. 32-40) to test the lawfulness of Hunt Oil Company's and other major producers' increased rates. Such a regulatory program will, of course, require Commission consideration of the records and cost of service determinations in those major cases in which hearing has been held. We have already pointed out (*supra*, p. 14, fn. 14) that it may

[21] Respondent has reported that as of June 30, 1961, there were 2,744 producer certificate proceedings and 3,838 producer rate increases pending and unresolved (1961 Annual Report, pp. 73, 79). Payments by pipelines under refundable producer rates were accumulating at the gargantuan rate of $758 million a year (*Id.* at 80). The increased producer rates lead inevitably to pipeline rate filings which consume time and attention of Respondent and its staff. Also, area proceedings are peculiarly ill-suited to the processing and decision of a multitude of refund claims which are affected or controlled by the costs and revenues of individual producers. The necessity of dealing with multiple refunds in such proceedings can only delay the setting of area rates governing rate increases and sales for the future.

well be impossible for Respondent to set lawful, nondiscriminatory rates solely for those schedules which have been increased without also adjusting high nonrefundable rates. It is perplexing, therefore, that Respondent has not seen fit to set just and reasonable rates in the *Hunt* proceeding, rather than merely to test the lawfulness of Hunt's rate increases, since the relief contemplated by Congress would involve relatively little additional effort.

Finally, it is significant that Respondent does not now contend that decision of the remaining producer cases is impossible or impractical with Respondent's existing resources. Respondent has received $1,900,000 additional appropriation for the fiscal year ending June 30, 1963, earmarked for over 100 additional staff members to be assigned primarily to producer regulation (P.L. 87-841; H. Rep. 1923, 87th Cong., 2d Sess., p. 10). Since a majority of the major producer cases are virtually completed, the major burden on the staff is past, so that it is free to devote the bulk of its manpower to the area proceedings. Any additional staff effort in those individual cases not yet completed will be greatly simplified by Respondent's restatement and clarification of regulatory principles in its recent *Hunt* opinion (App. B, *infra*, pp. 32-40).

It is, of course, possible that an *effective* interim regulatory program will require somewhat more staff and Commission attention than the current policy of fostering "settlements" at going price levels, plus occasional *ad hoc* decisions involving isolated rate schedules. Even if this proved the case, that would not, as we have pointed out (Br. 11-15), provide a legal justification for failure to regulate for a long period, since Respondent's discretion extends to selecting a method of regulation, but not to the decision to regulate *vel non*.

4. A MINIMUM OF FOUR TO SIX YEARS WILL BE REQUIRED TO FIX EFFECTIVE AREA RATES IN THE PILOT AREA PROCEEDING

Finally, Respondent argues (Br. 46-48) that even assuming consumers may be injured by its policy of deferring producer regulation under Sections 4 and 5(a) of the Act, such an injury will be short lived and thus justifiable because the "pilot" area rate cases involving the Permian Basin and South Louisiana will be concluded within a year or two. This carries with it the implication that Respondent's orders setting rates for the future and directing refunds of past amounts collected in those and other areas can be made effective so as to grant substantial consumer relief within this period of time. The actual state of these proceedings does not support any such implication, and demonstrates that no relief can reasonably be expected within that time period. It is barely possible, although highly improbable, that Respondent might be able to issue an order in the Permian Basin proceeding early in 1964. However, that case has just entered the cost phase, since the hearings to this point have been confined solely to examination of general economic issues. The proceeding must go through its most important hearing phase on costs and specific regulatory methods, briefs to the Examiner, a decision by the Examiner, exceptions to, and a decision by, Respondent. In view of the complexity and unprecedented nature of the case, the many unresolved issues, and the many important interests involved, it is unlikely in the extreme that Respondent could issue a decision in this case in much under two years. The South Louisiana case, Respondent's so-called "pilot" case, has not yet been noticed for hearing and is thus much further down the road.

Even more important, Respondent completely overlooks the high probability that rehearing will be sought in these pilot cases and that they will be taken to court. Respondent recognizes this fact in its decision in this case (R. 267); and it is, of course, utopian to assume that every party in these proceedings will be satisfied with Respondent's order. An appeal is virtually a foregone conclusion and such an appeal, including the inevitable petition for certiorari to this Court, can be expected to consume not less than eighteen months *if* certiorari is denied.

It follows that no actual rate reductions *can be expected* in the first pilot area rate proceeding in under three to four years. And this schedule, moreover, implies that there will be no unusual delays or difficulties encountered in concluding and deciding the proceeding, which is also an improbable assumption. Thus, a four year period is probably an unrealistic minimum. Furthermore, the Permian Basin is merely one of Respondent's fourteen gas pricing areas (R. 343), and one of the less important. No area program can become effective until Respondent has held hearings on and issued decisions based at least in part on the conditions in these various areas, including the all-important South Louisiana, Texas Gulf Coast and Panhandle-Hugoton production areas.

Finally, it is also improbable that Respondent could make its new regulatory program effective across the board, and order refunds of large sums of money and prospective adjustment of rates, until such time as constitutionality and lawfulness of the entire program have been authoritatively determined. Since major producers typically sell gas in most or all of Respond-

ent's pricing areas, the lawfulness of Respondent's method as applied to such producers will require comparison of the rates set in the various areas. Hence, the final judicial appraisal of the area approach will in all probability have to await the development of rates for all of the areas, which will be a lengthy process. It follows that the actual period of time consumed in deciding, applying and reviewing the most important area cases will certainly be far longer than four years. This is why the court below recognized, as it did, that the total time period was likely to be from four to fourteen years. It is Respondent's two year estimate (Br. 47) which is "highly unrealistic" in the light of the administrative realities, not that of the court below and these Petitioners.

Hence, existing consumers face at the very least an additional four to six years of non-regulation before Respondent's experimental rate program can merely *begin* to be made effective, more than a decade after *Phillips*.

CONCLUSION

For these reasons, as well as those set forth in Petitioners' main brief, it is respectfully requested that the opinion below be vacated, and that the Court of Appeals be directed to remand the cause to Respondent with instructions to reopen the proceedings, determine the lawfulness of Phillips' current rates and set future lawful rates, and order refunds of any amounts unlaw-

fully collected during past periods under those rates subject to refund.

Respectfully submitted,

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December, 1962

APPENDIX A

Respondent's brief (pp. 42-43) attacks both the accuracy and significance of the data contained in Appendices D-1 and D-2 of Petitioners' brief. This criticism completely ignores the significance of these data both absolutely and in the context of Respondent's available records and other data sources. The two appendix tables will be discussed separately.

Appendix D-1

This appendix reports the distribution of average prices paid for natural gas by interstate pipelines in South Louisiana in 1960 taken from the pipeline Form 2 reports on file with Respondent. These reports are the only complete source of this data.[1] Respondent correctly points out that interstate pipelines purchasing gas in South Louisiana sell a certain amount of it within that state, and in consequence certain of the volumes reported on Appendix D-1 represent non-jurisdictional transportation and sale of gas. However, the pipelines do not always identify such volumes in their Form 2 reports. It should be emphasized that since there are no other usable data which segregate the non-jurisdictional gas purchases, these are the *only* data available showing the distribution of prices paid by interstate pipelines in South Louisiana.

Assuming their accuracy, the price distribution data on Appendix D-1 are highly significant, since they show that 90 per cent of gas purchased by interstate pipelines in South Louisiana is now flowing at prices which exceed the

[1] Data supplied by the producers on Form 301 reports could in theory be used to isolate certain but not all non-jurisdictional sales, but since these data have not been compiled or abstracted by Respondent, and omit producers selling less than two billion cubic feet a year, it would be impracticable to attempt to utilize them both from the standpoint of accuracy and expense. Respondent's own published data on producer price distribution are derived from the Form 2 reports, not the 301 reports. (*Direct Sales by Producers of Natural Gas to Reporting Interstate Pipeline Companies*, 1956-1960; showing distribution by state and producer size groups).

Commission's increased ceiling price in that area, so that this ceiling price has become a dead letter.

Respondent argues (Br. 43), however, that the inclusion of the unidentified non-jurisdictional volumes makes these figures suspect and hence valueless. The fact is that the general level of intrastate prices in South Louisiana, as well as in other producing areas, is below the interstate price level, so that exclusion of intrastate volumes from the Appendix D-1 table would undoubtedly result in a higher average price, not in a lower average price. For example, if the volumes which are specifically identified in the Form 2 reports as intrastate are excluded from the data now appearing at Appendix D-1, the weighted average price increases from 20.57 cents per Mcf to 20.82 cents per Mcf. The weighted average price of the intrastate volumes thus excluded is 19.34 cents per Mcf.

Price Class	Intrastate[1] Mcf	Intrastate[1] Per Cent of Total	Other than Intrastate[1] Mcf	Other than Intrastate[1] Per Cent of Total
(Cents per Mcf)				
6.00- 6.99	0	0.00%	2,221,736	0.13%
7.00- 7.99	0	0.00	666,642	0.04
8.00- 8.99	21,878,503	6.33	1,431,176	0.08
9.00- 9.99	256,584	0.07	38,554,664	2.27
10.00-10.99	14,748,724	4.27	20,965,550	1.23
11.00-11.99	31,323,511	9.06	8,918,881	0.53
12.00-12.99	1,921,127	0.56	777,128	0.04
13.00-13.99	95,183	0.03	400,485	0.02
14.00-14.99	1,026,137	0.30	1,644,393	0.10
15.00-15.99	8,906,643	2.58	29,076,052	1.71
16.00-16.99	1,248,808	0.36	4,014,874	0.24
17.00-17.99	637,491	0.18	42,186,210	2.48
18.00-18.99	43,657,332	12.63	136,784,494	8.05
19.00-19.99	2,827,043	0.82	156,089,328	9.19
20.00-20.99	27,959,103	8.09	224,432,610	13.21
21.00-21.99	47,399,431[2]	13.71	289,783,822[3]	17.06
22.00-22.99	78,618,982	22.74	323,520,044	19.05
23.00-23.99	20,362,588	5.89	403,077,942	23.73
24.00-24.99	42,865,950	12.40	13,964,833	0.82
Total	345,743,140	100.00%	1,698,519,962	100.00%
Purchases above 21.25c	187,663,160	54.28%	940,664,076	55.38%
Weighted Average Price	19.34c		20.82c	

[1] Intrastate includes all gas identified as intrastate on the Form 2 reports and gas purchased by Olin Gas Transmission Co.

[2] 45,845,644 Mcf in this price class sold for more than 21.25 cents.

[3] 200,101,257 Mcf in this price class sold for more than 21.25 cents.

Source: Form 2 Reports, Year ended December 31, 1960.

It is also significant that 54.28 per cent of the identifiable intrastate volumes moved at prices above 21.25 cents, while 55.38 per cent of the other volumes moved at prices above that level. The reason for this close correspondence in two price levels can be found in the economics of the industry. Since the interstate market today represents roughly three-quarters of total Louisiana marketed production (Bureau of Mines Minerals Yearbook, 1960, Vol. II, p. 323), the going interstate price determines the market and acts as a ceiling on intrastate sales. As a result, intrastate prices tend to follow interstate levels, although lagging slightly behind them.

This general conclusion is supported by an uncontroverted study made by the producer witness Foster in the well-known CATCO proceeding[2] (Schedule 38 of Exhibit 12, Docket No. G-11024, *et al.*) which showed that in 1958 the average price paid for gas under all intrastate Louisiana contracts entered into in the years 1952 through 1958 was 17.34 cents per Mcf, and the average price for all interstate Louisiana contracts executed during the same period was 18.65 cents per Mcf. It is virtually certain, therefore, that if data were available permitting the segregation of interstate volumes, both the average price and price distribution of interstate sales would approximate that in Appendix D-1, except that the averages would be somewhat higher, rather than lower. Since these facts were readily available to Respondent and its staff, it is puzzling that it attempts to discredit the significance of the only available price distribution data for South Louisiana sales.

Appendix D-2.

Respondent also criticizes the Form 2 data compiled in Appendix D-2 of Petitioners' brief, and reworks this data in its Appendix C. Appendix D-2 attempts to approximate the volumes sold in 1960 by the 43 independent producers

[2] On remand from this Court in *Atlantic Refining Co. v. P.S.C. of New York*, 360 U.S. 378.

with active rate cases at prices above 21.25 cents per Mcf—Respondent's initial price ceiling—which are probably not subject to refund. This appendix was prepared utilizing data in the Form 2 reports filed by pipelines purchasing in South Louisiana for the year ended December 31, 1960, the only publicly available data of this kind (*supra*, p. 27, fn. 4). Petitioners were careful to point out (Br. 24, fn. 9) that these figures were only rough approximations, since the Form 2 data in many cases do not permit the segregation of interstate and intrastate sales. Respondent, by writing to the producers involved in such instances, has been able to determine that certain of the volumes which were not identified as being made under jurisdictional rate schedules in the Form 2 reports are actually subject to refund obligation. Respondent was also able to ascertain by writing to the producer involved that certain sales made by Olin Gas Transmission Company which were not identified in the Form 2 reports were intrastate in nature.[3]

Respondent's Appendix C as adjusted shows that approximately 44 million Mcf of gas were sold by 13 producers in South Louisiana in 1960 at prices in excess of 21.25 cents not subject to refund. Assuming an average price for these sales of 22.5 cents per Mcf, consumers were being charged in that year in excess of one-half million dollars over Respondent's current South Louisiana ceiling

[3] Respondent points out that part of these sales are identified as intrastate at pages 102 and 103 of Olin's Form 2 report. Those pages contain Olin's report on "Natural Gas Reserves Available from Purchase Agreements", and certain of the contracts listed have an asterisk footnote indicating "intrastate in nature". The total sales in 1960 under all such asterisked contracts for those producers included in the group of 13 is 27,981,383 Mcf instead of the 31,851,952 Mcf used in Appendix C, footnote 1. The difference, amounting to 3,870,569 Mcf, is a sale by Texaco shown on page 103, line 38 without an asterisk. Obviously, therefore, Respondent either made an error in its compilation or used an unidentified source for determining that the Texaco sale was in intrastate commerce.

price of 21.25 cents per Mcf which they will never be able to reclaim. Thus, Respondent's own recomputation of the Form 2 data demonstrates that substantial volumes of gas are moving at high non-refundable rates in South Louisiana, bearing in mind that these volumes relate only to the 13 major producers having active rate cases, and are confined only to this single producing area. Petitioners' main contention, of course, is that even the availability of refunds does not provide adequate protection to consumers, since it may be practically impossible to insure that refunds are actually made or reach consumers which have paid the unlawful rates. This contention has since been adopted by Respondent and this Court. *Tennessee Gas Transmission Co.* v. *F.P.C.*, No. 48, December 3, 1962.

Respondent in its Appendix C also attempts to adjust the 1960 Appendix D-1 data to reflect the results of certain producer rate settlements entered into in subsequent years after the preparation of Appendix D-2. This generates a meaningless figure since Respondent is attempting to apply 1962 prices to 1960 sales data, ignoring the fact that more gas may well have been sold at prices above 21.25 cents in 1962 than in 1960, even taking into account the fact that between those two years some prices were lowered due to settlement agreements. Thus, Respondent's records show that sales have been made at prices above 21.25 cents under South Louisiana rate schedules not in existence in 1960, and there have been subsequent increases in volumes under 1960 South Louisiana high price contracts. Obviously, it is necessary to look at 1962 sales at 1962 prices to determine how much gas is flowing in 1962 at above 21.25 cents, not 1960 sales at 1962 prices. Accordingly, the data set forth in the last two columns of the tabulation on Appendix C are meaningless.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Joseph C. Swidler, Chairman, Howard Morgan, L. J. O'Connor, Jr., Charles R. Ross, and Harold C. Woodward.

G-9065, G-9568, G-10414, G-11124, G-11360, G-13157, G-13191, G-13468, G-13504, G-13530, G-14082, G-14408, G-16422, G-16479, G-16639, G-18464, G-18555, G-18668, G-19755, G-19869, G-20009, G-20531, R160-202

HUNT OIL COMPANY

G-16644, G-16927, G-19756, G-20532

HUNT OIL COMPANY (Operator), *et al.*

G-18092

HUNT OIL COMPANY AND H. L. HUNT

Opinion No. 365

Opinion and Order Remanding Proceedings and Severing Proceeding

(Issued October 17, 1962)

SWIDLER, Chairman:

These proceedings involved a general investigation of Hunt Oil Company's rates which was ordered by the Commission under Section 5(a) of the Natural Gas Act. Consolidated therewith are 26 of Hunt's increased rate filings suspended under Section 4(e). On October 2, 1961, the presiding examiner in these proceedings issued an intermediate decision dismissing the 5(a) proceedings against Hunt and allowing all of the proposed increased rates.

The hearings in these proceedings were held in 1959 and the final briefs were filed with the examiner shortly before issuance of our Opinion No. 338 on September 28, 1960, in the *Phillips* case, Docket No. G-1148, 24 FPC 537, affirmed

Wisconsin v. *F.P.C.*, 303 F. 2d 380 (CADC), cert. granted, 369 U.S. 870. Various cost of service studies of the company were submitted during the hearings: five by Hunt, one by the Commission staff, and one by a group of intervenors. In addition, the Commission staff submitted a recommended rate design based on its own cost studies, and Hunt introduced a substantial amount of evidence on field prices and economic factors.

We have carefully examined the evidence of record and are forced to conclude that on this record Hunt has not justified its proposed increases because it has failed to submit evidence that will permit a proper determination of Hunt's jurisdictional rates. However, since the record was made prior to *Phillips*, when few guideposts had been laid down, we will remand the case to the examiner in order to give Hunt further opportunity to shoulder its burden of proof by introducing evidence solely on the items discussed herein in which we find the record deficient. Such evidence shall be restricted to data for the test year utilized in the present record. Other parties to the proceeding may also submit evidence under the same limitations if they so desire.

The only gas volumes of record for use in making an allocation of joint production costs are sales volumes. The relative cost method for allocating production costs which we approved in principle in *Phillips* and reaffirm herein requires the use of the volumes of oil and gas produced at the wellhead which Hunt has failed to put in evidence. Actual production data are also necessary to ascertain the Btu's at the wellhead for application of the modified Btu method for the allocation of exploration and development costs, which method we also reaffirm herein.[1]

[1] We make clear that allocations on the basis of unadjusted physical units of measurement of the type presented by Hunt herein are unacceptable except for processing costs. In addition to *Phillips*, supr., see *Continental Oil Company*, Opinion 351, issued January 22, 1962.

In establishing the single product oil and gas costs for Hunt, it appears that it will be necessary to include some gas condensate production in the gas leg in order to ascertain a normal reasonable cost to procure gas alone, as Hunt has only six dry gas properties. This was done in *Phillips* where it appears that a gas to oil ratio of 100 to 1 was used to determine a cutoff ratio for the condensate wells to be included. We realize that a cutoff ratio which gives a representative portion of the total gas production for one company may not necessarily be applicable to another company. However, only the minimum number of condensate wells necessary to obtain a representative portion of Hunt's gas production should be included in the gas leg, and the condensate wells so included in the gas leg should also have an allocation of the joint production costs made to the liquids. In establishing an oil leg only those oil wells from which no sales of gas are made should be included. Non-producing properties should not be included in ascertaining the gas and oil legs for allocation of the joint production costs.

Another point we find difficult to ascertain is the effective state production tax rate which should be employed in the cost of service determination. It appears from the exhibits that an amount of 1.9¢ per Mcf for all of Hunt's gas sales was applied for a test year of 1957. No taxes in 1957 appear to have been as high as the overall rate used.

It is impossible from the record to make a proper allocation of the cycling and gasoling plant costs. We made it clear in *Phillips* that all liquid extraction costs should be assigned directly to liquids and that the remaining gathering and processing costs should be allocated on a volumetric-Btu basis between the liquids and the gas. It is, of course, necessary to have the details as to the sources of the plant inlet volumes as well as sales volumes to make this allocation, and also to have the plant operations, costs and investments properly segregated and functionalized in

order to allow the examiner to ascertain at what point gathering and processing ends and extraction begins.

An additional item upon which the evidence is deficient concerns the disputed increase put into issue by Texas Eastern in Docket No. G-18092. Involved is the question of the contractual basis for the increase. We find no affirmative showing on the record that this increase was filed pursuant to the redetermination or favored-nation clauses in the contract, but as the case is being remanded we will give the examiner an opportunity to pass upon the issue in the first instance. Also, the examiner's findings as to the justness and reasonableness of Hunt's increased rates in Docket Nos. G-18464 and G-18555 are necessarily subject to a determination as to the contractual basis for the filings, such issue now being before the Commission on exceptions to the examiner's decision in Docket No. R161-515.

The principles noted above in our requirements for additional evidence adequately answer a number of points raised by the various exceptions to the examiner's initial decision in this proceeding. The other principal points raised in the exceptions involve the examiner's findings with regard to federal income taxes, allowances for "lease plays", rate of return, accounting methods and the weight to be accorded economic evidence.

Our examination of the record indicates that no further evidence is necessary to reach a decision with regard to these points. It appears that the examiner used the economic evidence in determining his rate of return and may also find it useful on the issue of the reasonableness of specific rates, which we discuss below. He could not, of course, use such evidence as a part of a mathematical determination of the actual cost of service. The question of the inclusion of federal income taxes is well settled, *Continental Oil Co.*, Op. 351, issued 1/22/62 and *El Paso Nat. Gas Co.* v. *F.P.C.*, 281 F. 2d 567, cert. denied 366 U.S. 912.

Since the examiner used a year-end rate base for Hunt, and we believe this is correct as long as year-end unit rev-

enues were also considered, there appears to be no need for a "lease play" allowance. In addition to the fact that Hunt did not adequately identify all of its sources of capital, any money actually expended to obtain leases during the test year would receive a full year's return through the use of a year-end rate base, even though some of the properties may have been purchased late in the test year.

The use of venture or asset accounting in ascertaining Hunt's cost of service has been made an issue, but it appears from this record that the actual difference in the amounts involved is very small. While we do not now hold that asset accounting is improper, we see no reason in this proceeding for departing from the venture accounting method which Hunt has always followed.

In addition to obtaining additional evidence and ascertaining a proper cost-of-service for Hunt it will also be necessary for the examiner to receive evidence and make findings as to whether the individual increased rates here in issue are just and reasonable. Our examination of the record in this case convinces us that increased rates for specific sales cannot always be found to be just and reasonable solely on the basis of a comparison of individual company-wide costs with that company's revenues in a test year. The mere fact, if it turns out to be a fact, that company-wide overall unit costs for the test period are greater than comparable unit revenues cannot justify all specific rate increases no matter how high they may be; the deficiency may well result from the fact that other sales are made at rates below that which could be justified on a cost basis. In any event consumers should not necessarily be obligated to make up overall revenue deficiencies by paying rates which are higher than those prevailing in the production area where this higher price cannot be individually justified.

The use of individual company costs as a method for determining whether an independent producer's increased rates are just and reasonable appears to be necessary if

we are to pass upon such rates at all prior to the establishment of area rates. Cost-of-service was the method which was used in this proceeding and others pending before the Commission prior to the commencement of the area rate proceedings and, as we have previously indicated, we intend to continue to process and decide such proceedings as promptly as the record in each case permits. We believe that the record in these proceedings, as supplemented on remand, should provide a basis for determination of the justness and reasonableness of Hunt's section 4 increased rates at the time they became effective.

The Section 5(a) aspect of the proceedings is in a different posture. There are currently pending area rate proceedings in the Permian Basin and Southern Louisiana in which a large percentage of Hunt's jurisdictional sales are the subject of investigations pursuant to Section 5(a). It is our hope that area proceedings will result in a timely determination of Hunt's rates for the future. However, in order to assure adequate protection to consumers against any unreasonably high rates of Hunt which may not be subject to an early determination on an area basis we will hold in abeyance further action on the 5(a) aspects of the case pending area rate determinations, with the understanding that 5(a) proceedings on some or all of Hunt's rates may be subject to reactivation if future circumstances should so dictate.

The Commission orders:

For the reasons stated, the proceedings in Hunt Oil Company, Docket Nos. G-9065, *et al.* are hereby remanded to the examiner for further hearing directed to the issues on which the evidence of record is deficient and issuance of a decision in conformity with this order, except in Docket No. G-10414, which is hereby severed from the consolidated proceedings.

By the Commission.

JOSEPH H. GUTRIDE,
Secretary.

Order Denying Petition for Reconsideration and Severing Proceeding

(Issued December 10, 1962)

On November 14, 1962, Hunt Oil Company filed a Petition for Reconsideration[1] of our Opinion No. 365, issued October 17, 1962, in which we remanded these proceedings to the presiding examiner for the reception of additional evidence and issuance of a new intermediate decision.

The main thrust of Hunt's petition is that our *Phillips* decision, Docket No. G-1148, 24 FPC 537, affirmed *Wisconsin* v. *F.P.C.*, 303 F. 2d 380 (CADC), cert. granted, 369 U.S. 870, was in many respects either incorrect in principle or inapplicable to the Hunt Oil Company. Hunt has apparently misread our order remanding these proceedings. On the existing record Hunt had not sustained its burden of proof but in the special circumstances of this case which was tried before our *Phillips* decision we remanded the case to the examiner to give *Hunt* a further opportunity to sustain its burden. Our remand order does not preclude Hunt from introducing evidence to substantiate its claim. On the contrary, the purpose of remanding the case rather than dismissing Hunt's rate increases was to afford Hunt precisely that opportunity. Hunt, of course, is free to renew any arguments it may have, based on the existing evidence and the additional evidence to be adduced, to convince us that in some respects the *Phillips* decision should not be followed.

In its petition Hunt has also argued that we should not have severed the 5(a) proceeding from the 4(e) proceedings and that it should not be limited to a 1957 test year.

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[1] Hunt's filing is entitled "Application for Rehearing"; however, under Section 1.34 of our Rules of Practice and Procedure, an Application for Rehearing may only be filed to a final order. As our Opinion 365 remanding these proceedings for further evidence cannot possibly be construed to be a final order, we are treating Hunt's filing as a petition for reconsideration.

The Commission is, of course, free to initiate a Section 5(a) proceeding against Hunt at any time so that Hunt is not prejudiced by our action in not terminating the Section 5 docket. The question concerning the propriety of a 1957 test year in a Section 5(a) proceeding would be appropriate if the proceeding is reactivated and is therefore premature.

In limiting the evidence to a 1957 test year with respect to the Section 4(e) cases, it was our intent to expedite a final determination in this already prolonged case. The 1957 year appears to be a proper test year for the Section 4(e) dockets at issue, most of which were filed shortly thereafter and have been superseded by other increased rate filings. If Hunt believes that its 1957 data are so unrepresentative of later periods as to override its desire for expedition of the proceedings, it may demonstrate that fact by introduction of complete data as to other year or years.

Our Opinion No. 365 did not determine any of the issues in these proceedings but indicated those issues on which the record was adequate and those which required further evidence. Hunt has also indicated the situation has changed with regard to the contractual basis for its filing in two of the dockets from that set forth in Opinion 365. If Hunt's allegations are correct, the examiner will, of course, so find in issuing his new decision on the remanded proceedings. With regard to Docket No. G-18092 it appears that it involves rates for another seller, H. L. Hunt, as well as Hunt Oil Company and the rates cannot properly be determined in these proceedings.

The Commission orders:

(A) For the reasons set forth above the Petition for Reconsideration, styled as an Application for Rehearing, filed by Hunt on November 14, 1962, in these proceedings to the extent not herein granted is hereby denied.

(B) Docket No. G-18092 is hereby severed from these proceedings.

By the Commission.

JOSEPH H. GUTRIDE,
Secretary.